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Review of the efficiency of the administrative and financial functioning of the United Nations

Guidelines for Internal Control Standards

Report of the Secretary-General

I. Introduction

1. The streamlining and strengthening of internal controls is an important area of the ongoing reform of the Organization. These efforts should proceed from a solid conceptual basis and specific benchmarks reflecting best practices in maintaining effective management control. Such a framework is provided by the Guidelines for Internal Control Standards approved by the International Organization of Supreme Audit Institutions (INTOSAI). INTOSAI is the professional organization of supreme audit institutions of virtually all member States of the United Nations.

2. The INTOSAI Guidelines, reproduced in the annex to the present report, are aimed at strengthening management control and enhancing more focused accountability in the public sector. The Guidelines specify the nature of the internal control structure and the objectives of internal controls. They emphasize that internal controls should serve as an effective management tool to promote cost-effective operations and services for the achievement of the Organization's mission, to safeguard resources against waste, abuse, mismanagement and fraud, to ensure adherence to legislative mandates, regulations and management directives and to foster the development of comprehensive and reliable financial and management data and information flows.

II. Nature and substance of the Guidelines for Internal Control Standards

3. The INTOSAI Guidelines are the result of an international effort to summarize, formalize and publicize best practices in effective internal controls of government management. They capture, in broad and general terms, the standards essential for effective internal controls in government management. They provide an overview of internal control concepts, objectives and standards, set out definitions and limitations of internal controls, review relevant standards and provide guidance on establishing the framework for internal control structures and recommendations on monitoring internal controls.

4. The general standards of internal controls include reasonable assurance by internal control structures that the Organization's objectives will be accomplished; a supportive attitude by managers and staff towards internal controls at all times; personal and professional integrity and competence of managers and employees regarding internal controls; and identifying and developing specific control objectives for

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each activity of the Organization. The Guidelines emphasize that the control objectives have to be comprehensive, reasonable and integrated into the overall organizational objectives. To be effective, internal controls must be appropriate, they must function consistently as planned and they must be cost-effective, so that the cost of implementing controls should not exceed the benefits derived.

5. Detailed control standards, which are the mechanisms or procedures by which control objectives are achieved, include:

(a) Transparent and comprehensive documentation concerning the internal control structure and all transactions and significant events, which should be readily available for examination;

(b) Prompt and proper recording of transactions and significant events;

(c) Strict observance of the scope of authority granted by persons authorizing and executing transactions and significant events;

(d) Separation of duties and responsibilities among individuals involved in authorizing, processing, recording and reviewing transactions and significant events;

(e) Competent supervision to ensure that internal control objectives are achieved;

(f) Access to resources and records to be limited to authorized individuals who are accountable for their custody and/or use.

III. Significance of the adoption of the Guidelines by the United Nations

6. Over the years, the United Nations has established the developed system of internal controls, most of which dovetail with the spirit and the letter of the INTOSAI Guidelines. The existing internal control structure is documented in the Secretary-General's bulletins, administrative instructions, management and personnel directives and procedures manuals for the areas of personnel, finance, accounting, procurement, field operations, etc. It is a long-standing requirement of the Organization that all transactions and significant events are promptly recorded, classified, approved and executed by formally authorized persons, with due regard to segregation of duties and competent supervision.

7. However, audits and inspections indicate that our internal control system shows gaps and deficiencies and that it requires consistent and continuous improvement and strengthening. While in some areas internal controls are slack or insufficient, in others many detailed procedural requirements already in place are stifling initiative and flexibility and creating situations where the cost of control is out of proportion to the risk or the value of potential loss. The ongoing reform demands that the internal controls be streamlined and fine-tuned in line with current best practices.

8. The INTOSAI Guidelines will provide the internationally recognized standard of such best practices and will allow management to check the efficiency of its internal controls against those standards. The formal acceptance of the INTOSAI Guidelines by the United Nations would not only signify the Organization's formal compliance with internationally approved standards of internal controls, but would also give impetus to and sharpen the focus of streamlining and strengthening internal controls in the course of reform.

9. With this is mind, the Secretary-General has decided to adopt the Guidelines for Internal Control Standards as a general substantive standard against which the Secretariat's internal control procedures and systems should conform, and has instructed the Under-Secretary-General for Management to take appropriate measures to bring the existing internal controls in line with INTOSAI standards. The INTOSAI Guidelines will be made widely available to management and staff both in hard copy and on the United Nations home page on the Internet. The Secretary-General is of the view that it would be appropriate to reflect the formal acceptance of the Guidelines in the Financial Regulations of the United Nations.

10. The INTOSAI Guidelines provide minimal acceptable standards of internal controls. The United Nations funds and programmes, whose programmatic and operational activities comprise a considerable share of their mandates, are at liberty to adopt a more extensive and specific system of internal controls, suitable to their areas of activity, of which INTOSAI standards will remain the core.

IV. Recommendation for action by the General Assembly

11. In accordance with the above, the Secretary-General proposes that the General Assembly adopt the following amendment to article X of the Financial Regulations of the United Nations:

"Regulation 10.1 (e):

"The internal control systems and procedures of the Organization should be in conformity, *mutatis mutandis*, with the Guidelines for Internal Control Standards approved by the International Organization of Supreme Audit Institutions in June 1992, or such later promulgations thereof which are acceptable to the Secretary-General."

Annex

Guidelines for Internal Control Standards

Internal Control Standards Committee

International Organization of Supreme Audit Institutions

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I. Introduction

Internal control has long been of interest to the members of the International Organization of Supreme Audit Institutions (INTOSAI). This interest can be traced to the 1974 Congress, where discussions were held about the need for internal audit and the importance of internal control systems. Since that time, interest in internal controls has grown as government management has become more complex, leading to difficulties for management in reviewing the correctness of every individual employee task. Many Governments are looking for ways to provide more economical, efficient and effective services and to control deficits and debt. This often involves reorganizing old structures, revising old procedures, allowing managers more freedom and increasing reliance on automated technologies. In such an environment, an effective internal control structure can provide reasonable assurance that management's objectives are being achieved.

The Committee on Internal Control Standards was formed to strengthen financial management and to establish more focused accountability in the public sector. Its goal is to develop guidance for establishing and maintaining effective internal controls. During the drafting of the present document, the Committee realized that these standards and guidelines are applicable to all managers, not only financial managers, and expanded the scope of the paper to cover all government operations. Therefore, this document's use of the term "internal controls" is not limited to the traditional view of financial and related administrative control, but covers the broader concept of management control.

The following member countries were involved in this project:

Austria, Court of Audit;
Chile, Office of the Comptroller General;
Egypt, Central Auditing Organization;
France, Court of Accounts;
Jamaica, Office of the Auditor General;
Spain, Tribunal of Accounts;
Tanzania, Exchequer and Audit Department;
United States of America, General Accounting Office;
Yugoslavia, Social Accounting Service.

The members identified four areas in which they believed guidance was needed to achieve the Committee's goal. These areas were:

(a) Concepts and objectives of internal controls;

(b) A minimal set of internal control standards that any State could use as a framework to develop a specific internal control structure;

(c) Implementation of an internal control structure;

(d) Periodic monitoring of the effectiveness of an internal control structure.

Each member of the Committee researched one of these four areas. The individual research papers were combined into a draft document for discussion by Committee members and was given to all INTOSAI members for comment. Those discussions and comments provided the Committee with insight into the use of internal controls by various systems of government.

The Committee discovered that while systems of government vary widely, the standards for strong internal controls are generally the same. The present document attempts to capture those standards and to present a consensus of the standards desirable in any specific internal control structure. Government management can use these standards to implement an effective internal control structure. Government auditors can use them to help evaluate those structures.

The Committee would like to thank the following countries for sharing their knowledge of and experience with internal controls and for taking the time to respond to our request for comments.

Australia
Belgium
Belize
Botswana
Canada
Colombia
Costa Rica
Czechoslovakia
Denmark
Finland
Germany
Haiti
Hungary
India
Ireland
Italy
Mauritania
Mexico
Netherlands
New Zealand
Norway
Pakistan
Panama
Peru
Philippines
Portugal
Qatar
St. Lucia
Sierra Leone
South Africa
Switzerland
Tunisia
Turkey
United Kingdom of Great Britain and Northern Ireland
Yemen
Zimbabwe

After incorporation of the comments, the Governing Board approved the issuance of these Guidelines for Internal Control Standards at its 35th meeting (Washington, D.C.,

October 1991). This is a "living" document reflecting the current trends in designing, implementing, and evaluating internal control structures.

Charles A. **Bowsher**
Comptroller General of the United States of America
Chairman, Internal Control Standards Committee

II. Overview of internal control concepts, objectives and standards

1. Internal control is a management tool used to provide reasonable assurance that management's objectives are being achieved. Therefore, responsibility for the adequacy and effectiveness of the internal control structure rests with management. The head of each governmental organization must ensure that a proper internal control structure is instituted, reviewed and updated to keep it effective.

2. The Supreme Audit Institution also has a responsibility for ensuring adequate internal control. It should encourage and support:

(a) The establishment of detailed organizational internal control structures for each governmental unit based on the standards presented in this document;

(b) A review of that structure to assure that internal controls are working as intended and are adequate to achieve the desired results.

3. As they are ultimately responsible for the adequacy of the internal control structure and its implementation, it is important that the management structures of all organizational units within government understand the nature of the internal control structure and the objectives of internal controls. An internal control structure is defined as the plans of an organization, including management's attitude, methods, procedures and other measures that provide reasonable assurance that the following general objectives are achieved:

(a) Promoting orderly, economical, efficient and effective operations and quality products and services consistent with the organization's mission;

(b) Safeguarding resources against loss resulting from waste, abuse, mismanagement, errors, fraud and other irregularities;

(c) Adhering to laws, regulations and management directives;

(d) Developing and maintaining reliable financial and management data and fairly disclosing such data in timely reports.

4. The following standards form the framework for an internal control structure and have been categorized under general standards and detailed standards:

A. General standards

Reasonable assurance: Internal control structures are to provide reasonable assurance that the aforementioned general objectives will be accomplished.

Supportive attitude: Managers and employees are to maintain and demonstrate a positive and supportive attitude towards internal controls at all times.

Integrity and competence: Managers and employees are to have personal and professional integrity and are to maintain a level of competence that allows them to understand the importance of developing, implementing and maintaining good internal controls and to accomplish the general objectives of internal controls.

Control objectives: Specific control objectives are to be identified or developed for each activity of the organization and are to be appropriate, comprehensive, reasonable and integrated into the overall organizational objectives.

Monitoring controls: Managers are to monitor continually their operations and to take prompt, responsive action on irregular, uneconomical, inefficient and ineffective operations.

B. Detailed standards

Documentation: The internal control structure and all transactions and significant events are to be clearly documented and such documentation is to be readily available for examination.

Prompt and Proper recording of transactions and events: Transactions and significant events are to be promptly recorded and properly classified.

Authorization and execution of transactions and events: Transactions and significant events are to be authorized and executed only by persons acting within the scope of their authority.

Separation of duties: Key duties and responsibilities in authorizing, processing, recording and reviewing

transactions and events should be separated among individuals.

Supervision: Competent supervision is to be provided to ensure that internal control objectives are achieved.

Access to and accountability for resources and records: Access to resources and records is to be limited to authorized individuals accountable for their custody or use. To ensure accountability, the resources are to be periodically compared with the recorded amounts to determine whether the two agree. The asset's vulnerability should determine the frequency of the comparison.

5. These standards are applicable to all governmental organizational units. They can be viewed as the minimum acceptable standards for organizations to follow when instituting internal controls and should provide criteria for auditors when auditing the internal control structure.

6. The standards presented here are not new ideas. Many of them are currently incorporated in government operations. Their presentation as a framework, however, may be new. The remainder of this document discusses in greater detail the definition and limitations of internal controls, the internal control standards, the establishment of the framework for internal controls and the implementation and monitoring of internal control structures.

III. Definition and limitations of internal controls

A. Definition and objectives

7. Internal control structures are defined as the plans of an organization, including management's attitude, methods, procedures and measures providing reasonable assurance that the objectives of the organization are being achieved. Those objectives are:

(a) Promoting orderly, economical, efficient and effective operations and quality products and services consistent with the organization's mission;

(b) Safeguarding resources against loss resulting from waste, abuse, mismanagement, errors, fraud and irregularities;

(c) Adhering to laws, regulations and management directives;

(d) Developing and maintaining reliable financial and management data and fairly disclosing such data in timely reports.

8. This definition of internal control structures and their objectives are intentionally broad in scope in order to cover all government operations. However, internal controls have been organized and defined in various other ways. The following descriptions have been provided as a point of reference.

9. When describing internal controls according to their role in the organizational structure, they have often been organized into the broad categories of management, administrative and accounting controls. Management controls are often viewed as encompassing all controls. They are the framework of the organization, involving all the plans, policies, procedures and practices needed for employees to achieve the entity's objectives. Administrative controls are those procedures and records concerning the decision-making processes that guide employees in carrying out authorized activities to achieve the organization's objectives. Accounting controls cover the procedures and documentation concerned with the safeguarding of assets and the reliability of financial records.

10. Internal controls have also been categorized by their intended purpose: to prevent errors (for example, by segregating duties and authorization requirements); to detect errors (for example, by establishing production standards to detect variances in actual results); to correct errors that have been detected (for example, by collecting an overpayment to a vendor); or to compensate for weak controls where the risk of loss is high and additional controls are needed.

11. In practice, the distinction among these various categories is often difficult to recognize because an effective internal control structure requires elements of each. Even the descriptions of each category of control can vary. However, regardless of how internal controls are organized or defined, they should not be thought of as alternatives to each other. They should be complementary. Any one control has advantages and disadvantages and an effective internal control structure uses a mixture of controls to compensate for the particular disadvantages of individual controls.

12. To be effective, internal controls must satisfy three basic criteria:

(a) They must be appropriate (that is, the right control in the right place and commensurate to the risk involved);

(b) They must function consistently as planned throughout the period (that is, be complied with carefully by all employees involved and not bypassed when key personnel are away or the workload is heavy);

(c) They must be cost-effective (that is, the cost of implementing the control should not exceed the benefits derived).

B. Limitations on internal control effectiveness

13. No internal control structure, however detailed and comprehensive, can by itself guarantee efficient administration and complete and accurate records or be foolproof against fraud, especially when those involved hold positions of authority or trust. Internal controls dependent on the segregation of duties can also be rendered ineffective where collusion by several individuals is involved. In addition, authorization controls can be abused by the person in whom the authority is vested and management is frequently in a position to override the controls it has established. To maintain an internal control structure that would eliminate the risk of loss is not realistic and would probably cost more than is warranted by the benefits derived.

14. Because any internal control structure depends on the human factor, it is subject to flaws in design, errors of judgement or interpretation, misunderstanding, carelessness, fatigue and distraction. While the competence and integrity of the personnel designing and operating the system may be controlled by selection and training, these qualities may alter owing to pressures from within and outside the agency. Furthermore, no matter how competent the staff, the controls they operate may become ineffective if they do not correctly understand their function in the control process or choose to ignore it.

15. Organizational changes and management attitude can have a profound impact on the effectiveness of an internal control structure and the personnel operating the structure. Thus, management needs to continually review and update controls, communicate changes to personnel and set an example by adhering to those controls.

IV. Discussion of the internal control standards

16. The establishment of demanding internal control standards is necessary, in particular in government, in view of its size, diversity, the volume of transactions, the multiplicity of records and numerous rules, regulations and laws. Because statutory provisions govern the management and control of public resources and public programmes, standards that govern and ensure such compliance are required.

17. Internal control standards are separated into two categories: general standards and detailed standards. Together, they define the framework for the minimum level of acceptability for an internal control structure in operation. They should be used as the criteria for both developing and evaluating internal controls. These internal control standards apply to all management, operational and administrative functions and should not be limited to financial operations. They also apply to all systems, whether automated or manual.

A. General standards

18. The general standards consist of reasonable assurance, supportive attitude, integrity and competence, control objectives and monitoring controls. Together, they provide the proper control environment within the organization.

Reasonable assurance

19. Internal control structures are to provide reasonable assurance that the general objectives will be accomplished.

20. Reasonable assurance signifies a satisfactory level of confidence under given considerations of costs, benefits and risks. Determining how much assurance is reasonable requires judgement. In exercising that judgement, managers should:

(a) Identify the risks inherent in their operations and the acceptable levels of risk under varying circumstances;

(b) Assess risk both quantitatively and qualitatively.

21. Reasonable assurance recognizes that the cost of internal controls should not exceed the benefits derived. Cost refers to the financial measure of resources consumed in accomplishing a specified purpose and the economic measure of a lost opportunity, such as a delay in operations, a decline in service levels or productivity or low employee morale. A benefit is measured by the degree to which the risk of failing to achieve a stated objective is reduced. Examples include, increasing the probability of detecting fraud, waste, abuse or error, preventing an improper activity or enhancing regulatory compliance.

22. Designing internal controls that are cost beneficial while reducing risk to an acceptable level requires that managers clearly understand overall objectives. Government managers may design systems with excessive controls in one area of their operations that adversely affect other

operations. For example, employees may try to circumvent burdensome procedures, inefficient operations may cause delays and diluted responsibilities may make it difficult to identify accountable individuals. Thus, benefits derived from excessive controls in one area may be outweighed by increased costs in others.

23. An example of inefficient operations follows. A government agency's field office is responsible for a construction project for homeless individuals. However, every variation from the original contract, regardless of its technical or financial impact, must be approved by headquarters with the objective of controlling costs and product quality. This slows down the construction project's progress, which may increase costs and harm one or more of the individuals whom the construction was intended to benefit. To improve efficiency, headquarters could delegate the authority for minor contract changes to the field office. The headquarters' office would still have adequate control of the construction costs and quality while reducing delays.

Supportive attitude

24. Managers and employees are to maintain and demonstrate a positive and supportive attitude towards internal controls at all times.

25. Attitude is established by top management and is reflected in all aspects of management's actions. The involvement and support of top government officials and legislators will foster a positive attitude. This attitude will also be fostered by managers committed to achieving strong controls through actions concerning agency organization, personnel practices, supervision, communication, protection and use of resources through systematic accountability; monitoring and reporting systems; seeking improvement suggestions from employees at all levels; and general leadership. Management can demonstrate its support for good internal controls by emphasizing the value of independent and objective internal auditing in identifying areas for improving performance quality and by responding to information developed through internal audits.

26. Employees must follow internal controls and take steps to promote the effectiveness of the controls. A supportive attitude will affect performance quality and, as a result, the quality of internal controls. When internal controls are a consistently high management priority, management initiates and fosters a positive and supportive attitude.

27. In the final analysis, the commitment by management in setting the "tone at the top" is critical in maintaining a positive and supportive attitude towards internal controls in an organization.

Integrity and competence

28. Managers and employees are to have personal and professional integrity and are to maintain a level of competence that allows them to understand the importance of developing, implementing and maintaining good internal controls and to accomplish the general objectives of internal controls.

29. Managers and employees must maintain and demonstrate, (a) personal and professional integrity and ethical values, (b) a level of skill necessary to help ensure effective and efficient performance, and (c) an understanding of internal controls sufficient to effectively discharge their responsibilities.

30. Many elements influence the integrity of managers and employees. The "tone at the top" is important. Personnel should periodically be reminded of their obligations under an operative code of conduct that comes from top management. Counselling and performance appraisals are also important. Overall performance appraisals should be based on an assessment of many critical factors, including the implementation and maintenance of effective internal controls.

31. Hiring and staffing decisions should include assurances that individuals have the proper education and experience to carry out their assigned jobs. Once on the job, the individual should be given the necessary formal and on-the-job training. Managers and employees who possess a good understanding of internal controls and are willing to take responsibility for them are vital to an effective control structure.

Control objectives

32. Specific control objectives are to be identified or developed for each ministry/department/agency activity and are to be appropriate, comprehensive, reasonable and integrated into the overall organizational objectives.

33. The objectives are the positive effects that management tries to attain or the adverse conditions/negative effects that management seeks to avoid. The objectives should be tailored to fit the specific operations in each activity while being consistent with the overall internal control objectives, similar to those presented in paragraph 7 above, which would be set forth by a central department/ministry or through legislation.

34. To develop specific control objectives, all operations should be grouped first into broad categories. Then, within each broad category, operations should be grouped into one or more sets of regularly recurring activities (such as

identifying, classifying, recording and reporting information) that are required to process a particular transaction or event. These groupings should be compatible with the organizational structure of the entity and its division of responsibilities.

35. Agency operations can often be broadly categorized as follows:

(a) Management activities cover the overall policy and planning, organization and audit functions;

(b) Programme (operational) activities are those that relate to the agency's mission;

(c) Financial activities cover the traditional control areas concerned with budget, the flow of funds (revenues and expenditures), related assets and liabilities and financial information;

(d) Administrative activities are those that provide support to the agency's primary mission, such as library services, mail processing and delivery, printing and procurement.

36. To develop the control objectives, the sets of recurring activities must be identified and analysed. For example, the recurring activities associated with the procurement of materials (an administrative activity), would include, (a) identifying needed items, (b) selecting a vendor, (c) contracting for the items, (d) receiving the items, and (e) checking for quality. One of the control objectives to be achieved in this area might be that only those requests for materials that meet management's criteria should be approved. Another may be that only requested materials should be accepted.

37. Obviously, the broad categories mentioned above interact and control objectives over this interaction must also be established. For example, while the above example was considered an administrative activity, payment for the materials is a financial activity and the use of the materials may be a programme activity. The categories would need to have interface in order to properly control and record the payment.

Monitoring controls

38. Managers are to continually monitor their operations and take prompt, responsive action on all findings of irregular, uneconomical, inefficient and ineffective operations.

39. Monitoring operations ensures that internal controls are achieving the desired results. Monitoring of operations should be built into the methods and procedures managers select to control operations and to ensure that the activities meet the objectives of the organization. Monitoring includes addressing audit findings and recommendations reported by their internal and external auditors to determine what corrective actions are needed.

B. Detailed standards

40. Detailed standards are the mechanisms or procedures by which control objectives are achieved. They include, but are not limited to, specific policies, procedures, plans of organization (including separation of duties) and physical arrangements (such as locks and fire alarms). Controls must provide reasonable assurance that the internal control objectives are being achieved continually. To do so, they must be effective and efficient and be designed to work together as a system, not individually.

41. To be effective, controls should fulfil their intended purpose in actual application. A set of controls designed to operate in a manual environment may not be effective in an automated environment. Therefore, the controls selected should provide the coverage they are supposed to provide and operate when intended. As for efficiency, controls should be designed to derive maximum benefit with minimum effort. Controls tested for effectiveness and efficiency should be those in actual operation and should be evaluated over time to ensure that they are continually used.

42. The following controls are those widely used in designing an orderly and effective internal control structure. The specific methods and procedures discussed within each are not exhaustive but are used as examples.

Documentation

43. The internal control structure and all transactions and significant events are to be clearly documented and the documentation is to be readily available for examination.

44. An organization must have written evidence of, (a) its internal control structure, including its objectives and control procedures, and (b) all pertinent aspects of significant events and transactions. Also, the documentation must be available and easily accessible for examination by appropriate personnel and the auditors.

45. Documentation of the internal control structure should include identification of an organization's structure and policies, its operating categories, related objectives and its control procedures. These should appear in documents such as management directives, administrative policies, procedures manuals and accounting manuals.

46. Documentation of transactions or significant events should be complete and accurate and should enable each transaction or event (and related information) to be traced from its inception, while it is in process, to after it is completed.

47. Documentation of the internal control structure, transactions, and significant events must have a clear purpose, contribute to achieving the organization's objectives and be useful to managers in controlling their operations and to auditors or others involved in analysing operations. Documentation without a clear purpose will hinder the efficiency and effectiveness of the organization.

Prompt and proper recording of transactions and events

48. Transactions and significant events are to be promptly recorded and properly classified.

49. Transactions and events must be promptly recorded as they occur if information is to maintain its relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event, including, (a) initiation and authorization, (b) all stages while in process, and (c) its final classification in summary records. It also applies to promptly updating all documentation for relevance.

50. Proper classification of transactions and events is also required to ensure that reliable information is available to management. Proper classification involves organizing and formatting of information from which reports, schedules and financial statements are prepared.

51. Prompt and proper recording of information is essential for assuring the timeliness and reliability of all information used by the organization to support its operations and decision-making.

Authorization and execution of transactions and events

52. Transactions and significant events are to be authorized and executed only by persons acting within the scope of their authority.

53. Management decides to exchange, transfer, use or commit resources for specified purposes under specific conditions. Authorization is the principal means of ensuring that only valid transactions and events are initiated as intended by management. Authorization, which should be documented and clearly communicated to managers and employees, should include the specific conditions and terms under which authorizations are to be made. Conforming to the terms of an authorization means that employees execute their assigned duties in accordance with directives and within the limitations established by management or legislation.

Separation of duties

54. Key duties and responsibilities in authorizing, processing, recording and reviewing transactions and events should be divided among individuals.

55. To reduce the risk of error, waste or wrongful acts and the risk of not detecting such problems, no one individual or section should control all key stages of a transaction or event. Rather, duties and responsibilities should be assigned systematically to a number of individuals to ensure that effective checks and balances exist. Key duties include authorizing and recording transactions, issuing and receiving assets, making payments and reviewing or auditing transactions. Collusion, however, can reduce or destroy the effectiveness of this internal control technique.

56. A small organization may have too few employees to use this technique properly. In such cases, management must be aware of the risks and compensate with other controls. Rotation of employees may help ensure that no one person deals with key aspects of transactions or events for an undue length of time. Also, encouraging or requiring annual holidays may help reduce risks.

Supervision

57. Competent supervision is to be provided to ensure that internal control objectives are achieved.

58. Supervisors are to review and approve, as appropriate, the assigned work of their employees. They must also provide their employees with the necessary guidance and training to help ensure that errors, waste and wrongful acts are minimized and that specific management directives are understood and achieved.

59. Assignment, review and approval of an employee's work requires, (a) clearly communicating the duties, responsibilities and accountabilities assigned each staff member, (b) systematically reviewing each member's work to the extent necessary, and (c) approving work at critical points to ensure that it flows as intended.

60. Assignment, review and approval of employee's work should result in the proper control of their activities, including, (a) following approved procedures and requirements, (b) detecting and eliminating errors, misunderstandings and improper practices, (c) discouraging wrongful acts from occurring or from recurring, and

(d) reviewing for efficient and effective operations. A supervisor's delegation of work should not diminish the supervisor's accountability for these responsibilities and duties.

Access to and accountability for resources and records

61. Access to resources and records is to be limited to authorized individuals who are accountable for their custody or use. To ensure accountability, the resources are to be periodically compared with the recorded amounts to determine whether the two agree. The asset's vulnerability should determine the frequency of the comparison.

62. Restricting access to resources reduces the risk of unauthorized use or loss to the government and helps achieve management directives. The degree of restriction depends on the vulnerability of the resource and the perceived risk of loss, both of which should be periodically assessed. For example, restricted access to and accountability for highly vulnerable documents, such as check stocks, can be achieved by, (a) keeping them locked in a safe, (b) assigning a sequential number to each document, and (c) assigning custodial accountability to responsible individuals.

63. When determining an asset's vulnerability, its cost, portability, exchangeability and perceived risk of loss or improper use should be considered.

V. Establishing the framework for internal control structures

64. A specific authority should be assigned the responsibility for developing and promulgating a government-wide definition of an internal control structure, the objectives to be achieved by that structure and the standards to be followed when designing an internal control structure. This responsibility could be assigned through constitutional or other legal enactment and given to a central organization with authority over various governmental organizations.

65. In some countries, the legislators will establish the overall objectives that the internal control structures should achieve while leaving the establishment of internal control standards to a responsible central organization. In others, the legislators set specific controls for certain operations in legislation.

66. Wherever the authority is assigned, the Supreme Audit Institution has a vital role to play in the development of the internal control structure. This role will be played directly or indirectly, largely depending on the Supreme Audit Institution's legal mandate and the organizational structure of the country's management system. If the responsibility rests with an authority other than the Supreme Audit Institution, that institution's comments and advice should be sought as a matter of course.

67. Where the Supreme Audit Institution is responsible for promulgating the standards, a clear distinction must be made between these standards and the specific internal control procedures that should be instituted by each organization. The Supreme Audit Institution has a vested interest in ensuring that satisfactory internal controls exist in the organizations it audits. However, it is important and necessary that independence be maintained. The Supreme Audit Institution should therefore not take the responsibility for implementing the specifics of the internal control procedures in any audited organization. This is properly management's job. However, it would be appropriate, and in some countries it is a requirement, for the Supreme Audit Institution to comment on the effectiveness of existing control arrangements and to make recommendations for improvement. This can be done without a loss of independence since the responsibility for deciding on and implementing the control provisions would still rest with the audited organization's management.

68. It may be appropriate for various central organizations to become involved to some extent in setting internal controls to be followed by all agencies. In some instances, the controls may be quite specific (for example, in matters relating to revenue collections, contract award, specifications for computerized information systems and human resource management). In other areas, especially those dealing with managerial controls, the controls may have to be more general. In either situation, the internal controls must permit the exercise of managerial judgement and initiative aimed at improving economy, efficiency and effectiveness.

69. The responsible central organization should review its internal control standards and make necessary amendments from time to time. The internal control standards and any amendments must be fully documented and promptly circulated to all organizations to which they apply.

70. When specific internal control standards and procedures are legislatively promulgated, the legislation should not be too restrictive. It should allow managers flexibility in modifying procedures as the operational

environment changes. Otherwise, internal controls may become outdated and inefficient before the legislation can be amended. The specifics of an internal control structure must be periodically reviewed and adjusted to keep pace with each organization's changing environment.

VI. Implementing and monitoring internal control structures

71. The Supreme Auditor should encourage and support management's establishment of internal controls. This can be done by educating management about its responsibilities for implementing and monitoring the control structures. The Supreme Auditor should also audit those structures to assure that controls are adequate to achieve the desired result.

A. Management's responsibilities

72. As stated earlier in this document, internal control is a management tool. It is management's responsibility to implement and monitor the specific internal controls for its operations. Even in countries where specific controls are set out in legislation, a manager has no less a responsibility for implementing and monitoring those controls. All managers should realize that a strong internal control structure is fundamental to their control of the organization, its purpose, operations and resources. They should accept responsibility for it.

73. To design, establish and maintain an effective internal control structure, managers should understand the objectives to be achieved. Legislation can provide a common understanding of the definition and objectives of internal control. It can also prescribe the policies managers are to follow to implement and monitor their internal control structures and to report on the adequacy of those structures.

74. Management often establishes an internal audit unit as part of its internal control structure. While internal auditors can be a valuable resource to educate and advise on internal controls, the internal auditor should not be a substitute for a strong internal control structure.

75. The internal control standards discussed earlier in this document require managers to continually monitor their operations. The quality of internal controls can be more formally assessed by requiring a periodic evaluation and report from managers to ensure that the controls for which they are responsible continue to be appropriate and are working as planned. These periodic management assessments can be mandated in a number of ways. They can become part of management's policies or they can be mandated administratively by a central oversight organization charged with overall government management responsibility. An effective means, however, is a legislative mandate requiring managers to annually assess their internal controls and report to the legislative body on, (a) the effectiveness and efficiency of internal controls in achieving their goals and objectives, and (b) their plans to correct weaknesses identified.

76. Even in countries where specific internal control procedures are legislatively mandated, managers have an obligation to identify ineffective and inefficient controls that may or actually do cost more than the benefits they are designed to achieve. A periodic management report to the legislative body, in addition to reports to the organization's management and to a central organization, provides some additional assurance that management is giving internal controls the attention needed to promote efficient and effective operations.

77. These evaluations should be made according to consistent procedures that meet minimum levels of acceptability. Management should have a clear plan for periodically evaluating its internal controls, reporting problems and correcting weakness. The types of procedures that might be considered include, (a) segmenting the organization into components, (b) identifying programmes and administrative functions within each component, (c) assessing the general control environment and the vulnerability within each programme and activity to waste, loss, impropriety or failure to meet other established objectives, (d) planning and scheduling internal control evaluations of selected programmes and functions, (e) evaluating and testing the effectiveness of the internal controls within the selected programmes and functions, (f) determining and scheduling corrective action where necessary, and (g) reporting the results of the overall assessment and the corrective action to be taken.

78. Management can also use its internal audit unit to help monitor the effectiveness of internal controls. The closeness of internal auditors to the day-to-day operations usually places them in a position to continually assess the adequacy and effectiveness of internal controls and the extent of compliance. The internal auditors have a responsibility to management for reporting any inadequacies in the internal controls and any failure of employees to adhere to them and for recommending areas needing improvement. In addition, they should establish procedures for following up on previously reported internal and external audit findings to

ensure that managers have adequately addressed and resolved the matters brought to their attention.

79. As soon as weaknesses are found, corrective action must be taken which could involve several levels of government management. Corrective action may require legislatures to change existing laws, central organizations to revise internal control standards and procedures and management to revise its internal control structure.

B. Supreme auditor's responsibilities

80. The Supreme Audit Institution should gear its work towards assessing the adequacy in principle and the effectiveness in practice of existing internal controls in audited organizations. Where these are found to be inadequate, the weaknesses, their causes and possible effects should be fully documented and promptly communicated to the audited organization. When discussing controls with management, the auditor may want to use the term "management control" instead of "internal control" to reinforce the notion that control issues are much broader than traditional financial controls. Recommendations should also be made both formally and informally on how to correct the situation. Before making these recommendations, the Supreme Audit Institution should seek the audited organization's views and strive to ensure that the recommendations are relevant and practical. In particular, the cost of implementing the proposed control measures should be related to the risk inherent in the prevailing situation.

81. In some countries, private commercial auditors audit certain government organizations. In such cases, these auditors and the professional bodies to which they belong should provide advice and recommendations on the internal controls the audited agencies should implement.

82. When assessing internal controls, the auditors should consider taking the following steps:

(a) Determining the significance and the sensitivity of the programme subject matter for which controls are being assessed;

(b) Assessing susceptibility to misuse of resources, failure to attain objectives and non-compliance with laws and regulations;

(c) Identifying and understanding the relevant internal controls;

(d) Determining what is already known about control effectiveness;

(e) Assessing the adequacy of the control design;

(f) Determining, through testing, if controls are effective;

(g) Reporting on the internal control assessments and discussing needed corrective actions.

83. The Supreme Audit Institution should ensure that satisfactory internal controls exist in key facets of the auditee's operations. Without satisfactory controls, management may not detect serious errors and irregularities and the work of the Supreme Audit Institution becomes more difficult because of the increased need for audit scope, staff and time. Yet, available time and other resources are unlikely to allow for more than a limited check of projects, operations and transactions. With weak internal controls and limited audit coverage, many things could go wrong without detection by either management or the Supreme Audit Institution.

84. The Supreme Audit Institution also has a vested interest in ensuring that strong internal audit units exist where needed. Those audit units constitute an important element of internal control by providing a continuous means for improving an organization's operations. In some countries, however, the internal audit units may lack independence, be weak or non-existent. In those cases, the Supreme Audit Institution should, whenever possible, offer assistance and guidance for establishing and developing such capability. This assistance might include secondment or lending of staff, conducting lectures, sharing training materials and developing methodologies and work programmes.

85. The Supreme Audit Institution also needs to develop a good working relationship with the internal audit units so that experience and knowledge can be shared and the work of each can be supplemented and complemented. This relationship can be developed by including internal audit observations and recognizing their contributions in the external audit report when appropriate. The Supreme Audit Institution should develop procedures for assessing the internal audit unit's work to determine the extent to which it can be relied upon. A strong internal audit unit could reduce the audit work required of the Supreme Audit Institution and prevent needless duplication of work. The Supreme Audit Institution should ensure that it has access to internal auditor reports, related working papers and audit resolution information.